Supreme Court of the United States.

OCTOBER TERM, 1947.

No. 157.

COMMONWEALTH OF MASSACHUSETTS ET AL.,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

BRIEF FOR CARLTON W. SPENCER AND THE COMMONWEALTH OF MASSACHUSETTS.

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I. The Opinions Below.

The opinion of the District Court of the United States for the District of Massachusetts, entered on May 1, 1946, is officially reported at 65 F. Supp. 763 (R. pp. 13-18).

The opinion of the Circuit Court of Appeals for the First Circuit, entered on April 2, 1947, is officially reported at 160 F. (2d) 614 (R. pp. 29-34).

II. Jurisdiction.

The jurisdiction of this Court is invoked under Section 240 of the Judicial Code (28 U.S.C. 347), as amended.

III. Statement of the Case.

In the case at bar the facts are as follows: February 3, 1939, Somerville Sales and Service, Inc., being insolvent in the bankruptcy sense, made a common-law assignment for the benefit of creditors to Spencer. The United States Commissioner of Internal Revenue thereafter assessed against the corporation $963.08 on account of the assignor's 1938 taxes under Title IX of the Social Security Act, $690.05 on account of the assignor's 1938 and 1939 taxes under Title VIII of the Social Security Act and $21 on account of the assignor's 1939 United States capital stock taxes. The Commonwealth of Massachusetts duly and seasonably filed a claim with the defendant, as assignee, for $803.72 for unemployment taxes due from the assignor under the Massachusetts Unemployment Compensation Act, Mass. G.L. (Ter. Ed.) Chapter 151A (Annotated Laws of Massachusetts, Chapter 151A, Recompiled 1942). On October 6, 1939, Spencer paid $803.72 to the Commonwealth of Massachusetts on account of obligations of his assignor under the Massachusetts Unemployment Compensation Act. Of this amount, $775.34 represented 1938 contributions and $28.38 represented 1939 contributions. Spencer paid the remaining assets of $331.39 to the Collector of Internal Revenue on account of Title VIII, Title IX and capital stock taxes assessed by the United States Commissioner of Internal Revenue. This $331.39 was applied by the Collector of Internal Revenue on account of the assignor's taxes under Title VIII of the Social Security Act. The Commonwealth has agreed to pay over to the United States the amount of $803.72 which was paid to the Commonwealth by Spencer, if this payment was in disregard of U.S. Revised Statutes, Section 3466. The United States has agreed that, if it prevails, judgment in this case shall be limited to $803.72.

On these facts, the District Court, on May 1, 1946, held that the United States had priority for the full amount of its capital stock and Title VIII taxes and for 10 per cent of Title IX taxes, but that it could not recover the remaining 90 per cent of said tax, on the ground that the taxpayer or his assignee had the alternative right to pay 90 per cent of his obligation under Title IX to an approved State unemployment fund (65 F. Supp. 763) (R. p. 38).

On appeal and cross-appeal, the Circuit Court of Appeals for the First Circuit, on April 2, 1947, affirmed the judgment of the District Court as to capital stock and Title VIII taxes but reversed said judgment as to Title IX taxes, holding, in substance, that the taxpayer's assignee had no right to pay any part of the Title IX taxes to a State unemployment fund and that the United States had priority, under R. S. 3466, for the *full* amount of capital stock taxes, Title VIII taxes *and* Title IX taxes (160 F. (2d) 614) (R. p. 33).

IV. Issue.

Where a taxpayer owing Federal capital stock, Title VIII, Title IX, and other Federal taxes and State unemployment taxes becomes insolvent and makes an assignment for the benefit of his creditors, and his assignee has available as funds of the taxpayer a sum of money which is less than 90 per cent of the amount of Title IX taxes, may the assignee make payment of the State unemployment tax to the exclusion of the Federal Government claim for Title IX taxes or any other taxes due the Federal Government from the taxpayer?

V. Applicable Statutes.

Social Security Act of August 14, 1935, Title IX, Section 901 and Section 902 (U.S. Code, 1940 ed., Title 42, Chapter 7, Subchapter IX, Sections 1101, 1102). These sections are now incorporated in and superseded by Sections 1600 and 1601(a) of the Internal Revenue Code of 1939 and Supplement I thereto:

"Sec. 901. Imposition of tax.

"On and after January 1, 1936, every employer (as defined in section 907 of this title) shall pay for each calendar year an excise tax, with respect to having individuals in his employ, equal to the following percentages of the total wages (as defined in section 907 of this title) payable by him (regardless of the time of payment) with respect to employment (as defined in section 907 of this chapter) during such calendar year:

"(1) With respect to employment during the calendar year 1936 the rate shall be 1 per centum;

"(2) With respect to employment during the calendar year 1937 the rate shall be 2 per centum;

"(3) With respect to employment after December 31, 1937, the rate shall be 3 per centum. (Aug. 14, 1935, ch. 531, Title IX, § 901, 49 Stat. 639.)"

"Sec. 902. Credit against tax.

"The taxpayer may credit against the tax imposed by section 901 the amount of contributions, with respect to employment during the taxable year, paid by him (before the date of filing his return for the taxable year) into an unemployment fund under a State law. The total credit allowed to a taxpayer under this section for all contributions paid into unemployment

funds with respect to employment during such taxable year shall not exceed 90 per centum of the tax against which it is credited, and credit shall be allowed only for contributions made under the laws of States certified for the taxable year as provided in section 903."

Social Security Act Amendments of 1939, Title IX, Section 902(a)(1), approved August 10, 1939:

"Sec. 902 (a). Against the tax imposed by section 901 of the Social Security Act for the calendar year 1936, 1937, or 1938, any taxpayer shall be allowed credit for the amount of contributions, with respect to employment during such year, paid by him into an unemployment fund under a State law—

"(1) Before the sixtieth day after the date of the enactment of this act . . ."

Revenue Act of 1938, Section 810(a), effective May 28, 1938; Second Revenue Act of 1940, Section 701(a), approved October 8, 1940; Revenue Act of 1941, Section 701(a), approved September 20, 1941; Revenue Act of 1943, Section 601, passed February 25, 1944:

"Sec. 601. Credits against Federal Unemployment Taxes.—(a) Section 1601 (a) (3) (relating to the time within which contributions are required to be paid in order to be allowable as credit) is amended to read as follows:

"(3) The credit against the tax for any taxable year shall be permitted only for contributions paid on or before the last day upon which the taxpayer is required under section 1604 to file a return for such year; except that credit shall be permitted for contributions

paid after such last day, but such credit shall not exceed 90 per centum of the amount which would have been allowable as credit on account of such contributions had they been paid on or before such last day."

U.S. Revised Statutes, Section 3466, Act of March 3, 1797 (U.S. Code, 1940 ed., Title 31, Section 191):

"Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed."

Massachusetts State Unemployment Law, General Laws (Ter. Ed.) Chapter 151A, as amended.

VI. Argument.*

Any discussion of this subject must take cognizance of the history and operation of this social legislation which clearly indicates the close integration and inter-relationships between the Federal and State measures to combat the evils of unemployment.

*The history of unemployment insurance legislation, consideration of related Federal statutes and argument in the brief filed by the State of Illinois, as *amicus curiae* in this action, are so capably presented that a considerable part thereof is reproduced herein. Due acknowledgment of the use thereof is hereby made.

The critical conditions which give rise to a national program of unemployment insurance have been graphically described by this Court in *Steward Machine Company* v. *Davis*, 301 U.S. 548, which involved the constitutionality of Title IX, where this Court, at pages 586-588, declared:

> ". . . there is no need to remind ourselves of facts as to the problem of unemployment . . . During the years 1929 to 1936, when the country was passing through a cyclical depression, the number of the unemployed mounted to unprecedented heights. Often the average was more than 10 million; at times a peak was attained of 16 million or more. Disaster to the breadwinner meant disaster to dependents. . . . The fact developed quickly that the states were unable to give the requisite relief. The problem had become national in area and dimensions. There was need of help from the nation if the people were not to starve. It is too late today for the argument to be heard with tolerance that in a crisis so extreme the use of the moneys of the nation to relieve the unemployed and their dependents is a use for any purpose narrower than the promotion of the general welfare. Cf. *United States* v. *Butler*, 297 U. S. 1, 65, 66, *Helvering* v. *Davis*, decided herewith, *post*, p. 619. The nation responded to the call of the distressed. Between January 1, 1933 and July 1, 1936, the states . . . incurred obligations of $689,291,802 for emergency relief; local subdivisions an additional $775,675,366. In the same period the obligations for emergency relief incurred by the national government were $2,929,307,125, or twice the obligations of states and local agencies combined. According to the President's budget message for the fiscal year 1938, the national government ex-

pended for public works and unemployment relief for the three fiscal years 1934, 1935, and 1936, the stupendous total of $8,681,000,000. The *parens patriae* has many reasons—fiscal and economic as well as social and moral—for planning to mitigate disasters that bring these burdens in their train. . . . in so far as there was failure by the states to contribute relief according to the measure of their capacity, a disproportionate burden, and a mountainous one, was laid upon the resources of the Government of the nation."

In *Helvering* v. *Davis*, 301 U.S. 619, which involved an attack upon the constitutionality of Titles II and VIII of the Social Security Act (Old Age Benefits), this Court, at page 641, stated:

". . . The purge of nation-wide calamity that began in 1929 has taught us many lessons. Not the least is the solidarity of interests that may once have seemed to be divided. Unemployment spreads from State to State, the hinterland now settled that in pioneer days gave an avenue of escape. . . . Spreading from State to State, unemployment is an ill not particular but general, which may be checked, if Congress so determines, by the resources of the Nation. If this can have been doubtful until now, our ruling today in the case of the *Steward Machine Co., supra*, has set the doubt at rest. . . ."

The national scope of the problem of unemployment was stressed by the President of the United States in his message to Congress on June 8, 1934,[1] wherein he declared:

"We are compelled to employ the active interests of the nation as a whole through government in order

[1] Cong. Rec., Vol. 78, Pt. 10, p. 10770.

> to encourage a greater security for each individual who composes it. . . . If, as our Constitution tells us, the Federal government was established, among other things, 'to promote the general welfare' it is our plain duty to provide for that security upon which welfare depends. . . ."

Both branches of Congress emphasized that unemployment relief posed the most serious question for the nation.[2]

It was a problem, nation-wide in scope, which could not be combated by the States acting individually. Moreover, most States were reluctant to enact unemployment compensation legislation for fear of imposing the additional burden of taxation entailed upon their already depressed industries, thus placing their industries at a disadvantage in competing with industries of States which had no such legislation.

To cope with the problem of unemployment, Congress enacted Titles III, VII and IX of the Social Security Act.[3] Briefly, Title IX levied a uniform payroll tax on employers of eight or more throughout the nation. *The Federal statute*, however, is not of itself a complete unemployment compensation law; it provides payroll taxes but *makes no provision for the payment of unemployment compensation to unemployed workers, leaving that function to the States.*

It is obvious that a mere plan for taxation would not solve the problem which faced Congress and the nation. The heart of any plan to remedy the evil of unemployment is the stabilization of employment and *the payments of benefits to unemployed workers to cushion and thereby*

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[2] Senate Report No. 628, 74th Congress, 1st Session, p. 10; House Report No. 615, 74th Congress, 1st Session, p. 7.

[3] Chapter 531, 49 Stat. 620.

prevent the cumulated effects of loss of income. This vital function, under the Federal plan, was to be carried on *by the States* in the systems which the Federal Act sought to stimulate.

The Federal plan was simply this: As most States were hesitant to set up unemployment compensation systems, because of the disadvantage it would impose upon their industries in interstate competition, the Federal plan levied a tax on employers of *all* States, and then proceeded to allow an offset credit up to 90 per cent of the Federal tax to those employers who contributed to State unemployment compensation funds. The combination of the nation-wide tax and the offset credit for amounts paid into State funds thereby equalized the burden on all industries. Since employers of all States were obliged to pay the Federal payroll tax, and yet the Federal Government paid no benefits to workers, the plan of the Federal legislation both removed the fear of disadvantage in interstate competition and offered an inducement to the States to set up approved unemployment compensation systems whereby the State employers could obtain the offset credit and the State workers could obtain benefits in the event of unemployment.

Further to encourage the States to establish unemployment compensation systems, Congress, in Title III of the Social Security Act, provided for grants to cover the administrative costs of such systems. The funds for such grants are appropriated by Congress from the 10 per cent of the Federal tax which the Government retains for the purpose of meeting the costs of administering the State unemployment compensation systems. However, as in Title IX, the State unemployment compensation laws are required to meet certain minimum criteria.

As stated by the President in his message to Congress on January 17, 1935,[4] sponsoring the Federal law:

> "With respect to Unemployment Compensation, I have concluded that the most practical proposal is the levying of a uniform Federal pay roll tax, 90 per cent of which should be allowed as an offset to employers contributing under a State Unemployment Compensation Act. The purpose of this is to afford a requirement of a reasonable uniform character for all states cooperating with the Federal Government, and *to promote and encourage the passage of unemployment compensation laws in the states.* The ten per cent offset should be used to cover the cost of Federal and State administration of this broad system." (Emphasis added.)

The 90 per cent credit provision in the Federal law was designed to encourage the passage of State unemployment compensation laws which would provide the actual protection against unemployment by the payment of benefits. It provides that each employer may reduce his Federal tax up to 90 per cent by the amount he has contributed to a State unemployment compensation fund.

The Federal tax being 3 per cent of the payroll, practically all States enacted legislation calling for a standard tax of 2.7 per cent of the payroll of employers subject to the scope of their legislation, the 2.7 per cent rate being equivalent of 90 per cent of the Federal tax. Thus an employer paying the full State tax and offsetting this amount against his Federal tax paid no more than if he had paid the full Federal tax to the Federal Government, yet the amount he paid to the State went into the funds

[4] Cong. Rec., Vol. 79, Pt. 1, p. 546.

which actually operated as the protective device against the menace of unemployment.

Under normal conditions where the employer is solvent, the credit provisions operate as follows:

If a Massachusetts employer had a taxable payroll in the amount of $100,000 in the year 1938, it would have had a Federal tax (without deducting the offset credit) of $3000. Contributions to the Commonwealth of Massachusetts at the rate of 2.7 per cent would amount to $2700. If the employer paid the State, he would be able to credit the State payments against the Federal tax to the extent of 90 per cent of the latter. Since the amount of $2700 is exactly 90 per cent of $3000, the amount of the Federal tax, the employer would be entitled to offset the full amount of the payment to the State against the Federal tax and the amount actually due the Federal Government would have been $300, rather than $3000.

The plain purpose of the credit is to build up an adequate fund through the payment of contributions into the State unemployment compensation systems through which the fundamental purpose of the entire legislation would be effected. Clearly, Congress was not concerned with Federal revenue in this measure, for the credit provision clearly indicates that 90 per cent of the tax was never intended to flow into the Federal revenue. That 90 per cent was a lever to pressure the States into enacting unemployment compensation systems necessary to fulfill the end sought by the Social Security legislation. It must be borne in mind that the Federal Government paid no benefits and the success of the plan to combat unemployment depended on the State systems which insured the worker against loss of income in the event of unemployment.

That these principles were uppermost in the mind of Congress in extending the credit is apparent from an examination of the reports of both the Senate Finance

Committee and the House Committee on Ways and Means.[5] Moreover, Congress believed that the general welfare of the country would be better served by the payment of contributions into State unemployment compensation funds than by the payment of the tax to the Federal Government.

Steward Machine Company v. *Davis*, *supra*, p. 589.

Under Title IX, the 90 per cent credit may be taken when the State has been paid on or before the last day on which the employer is required to file its yearly Federal return, *i.e.*, February 1 of the following year. However, if the payment was made to the State after February 1, but on or before the following June 30, a credit of 81 per cent was permitted against the Federal tax. This reduction in the amount of credit allowed after February 1 provided an inducement to employers to make prompt payment to the States.

Further evidence in Title IX that Congress was primarily interested in building up the State funds lies in the removal of the time limitation for the obtaining of the full 90 per cent credit in those cases where the assets of the employer are in the hands of a court of competent jurisdiction at any time between the due date and the following June 30.

Nor is it only in Title IX that Congress has evidenced its intent to build up State funds, for time and time again Congress has demonstrated that it is the payment of contributions to the States which advances the purposes of the Federal Government. Although the credit against the Federal tax was originally allowed only if contributions

[5] Senate Report No. 628, 74th Congress, 1st Session, p. 15; House Report No. 615, 74th Congress, 1st Session, p. 16.

to State funds were paid within a specified period of time, Congress has repeatedly amended Title IX so as to extend the credit to taxpayers who are delinquent in the payment of contributions, in order to induce them to pay their contributions to the States.[6]

In the Second Revenue Act of 1940, Congress waived the time for obtaining credit against the Federal tax in the case of any taxpayer who was delinquent in his 1936, 1937, 1938 or 1939 contributions to a State fund. Such taxpayers were allowed the full 90 per cent credit if they paid their 1936, 1937 or 1938 contributions to their own State before December 6, 1940. As to the 1939 contributions, the credit was limited to 81 per cent of the Federal tax, except that the full 90 per cent credit could be taken regardless of the date when paid to a State fund, in those cases where the assets of the taxpayer were in the control of a receiver appointed by or under the control of a court in the period subsequent to the passage of the Act and December 6, 1940.

In the same Act, another special exception is made where contributions have been paid by mistake to the wrong State. In such case, payment under the proper State law is considered to have been made on the date of the erroneous payment, for the purposes of credit against the Federal tax.

The Revenue Act of 1941 continued the policy of encouraging the payment of delinquent contributions to the State by allowing full credit against the Federal tax for the payment of State taxes for 1936, 1937 and 1938, and by allowing a credit of 81 per cent for the payment of 1939 and 1940 State unemployment compensation contributions.

Finally, in the Revenue Act of 1943 (Section 602, Public Law 235, enacted February 25, 1944) Congress extended

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[6] Section 1601, Internal Revenue Act of 1939; Section 701, Second Revenue Act of 1940; Section 701, Revenue Act of 1941; Section 602, Revenue Act of 1943.

the 81 per cent credit offset for the payment of delinquent taxes for any year, *regardless of the date of payment of State contributions.*

It is to be stressed that, in the absence of these foregoing enactments waiving the time limitations, the Federal Government would have been entitled to the full 3 per cent, *regardless of whether or not the State was paid.* Yet the Federal Government has repeatedly foregone the collection of taxes *actually due to it* in order to induce payment of contributions into State funds. It is apparent that Congress intended the Federal Government should receive only three-tenths of 1 per cent and that the additional amount which it continually waived in favor of the payment into State funds was the device whereby taxpayers would be induced to pay their State contributions.

Thus, by the numerous exceptions extending the time for credit, Congress has clearly indicated that its prime concern is in the building up of State funds for the payment of unemployment benefits. *Any doubt that Congress did not consider this as a source of revenue for the Federal Government is resolved by the 1937 Act of Congress,*[7] *wherein Congress authorized an appropriation in excess of $20,000,000 to the unemployment compensation fund of the State of Illinois. This represented 90 per cent of the taxes which the Federal Government had collected from Illinois employers prior to the enactment of the Illinois Unemployment Compensation Act.*

The intention of Congress to achieve the purposes for which Title IX was enacted, through the payment of contributions into State unemployment compensation systems, is strikingly revealed in this action, which was part of legislation which turned back 90 per cent of the taxes

[7] Public Act 353, Chapter 755, 50 Stat. 754; Second Deficiency Appropriation Act of 1938, Chapter 681, 52 Stat. 1148.

collected from employers prior to the enactment of State systems into the State unemployment compensation systems which had been established subsequent to the initial payments of taxes under Title IX. Nothing could demonstrate more clearly the Congressional intent that the State should receive 90 per cent of the amount due the Federal Government under Title IX."

Further illustration of the interest of Congress in this measure as part of a plan to stabilize employment and not as a revenue source is disclosed in its willingness to allow the taxpayer to offset against the Federal tax the *credit* which he has received against State contributions under a State plan of experience rating. Ordinarily, where the Federal tax is 3 per cent of the payroll and the State tax is 2.7 per cent, contributions paid into the State fund equal 90 per cent of the Federal tax and the entire credit is obtained.

However, under the "experience rating" provisions of the Massachusetts Unemployment Compensation Act and of the Acts of other States, employers may pay contributions at a lower rate; in Massachusetts as low as five-tenths of 1 per cent. Thus, employers who have a stable employment record are required to pay contributions which amount to considerably less than 90 per cent of the Federal tax. This experience rating plan by the reward of a lower rate is intended to induce employers to stabilize their employment, and so, if the employer were allowed to credit against the Federal tax only what he *actually* paid into the State fund, his total tax would remain the same and the inducement would fail of its purpose. Consequently, to avoid disappointing this incentive, the Federal law [8] permits the taxpayer, in addition

[8] Title IX, Social Security Act, 1937; Section 1602, Internal Revenue Code, 1939.

to the credit for the amount actually paid to the State funds, to take a further credit equal to the difference between the amount of State contributions which he would have had to pay, had he not secured the reduced rate, and the amount that he actually paid to the State. In other words, the additional credit equals the amount of the reduction in the State tax.

This provision illustrates quite clearly the obvious intention of Congress that the United States was to receive only three-tenths of 1 per cent and that Congress was willing to offset against the Federal tax not only the actual amounts paid into State funds but also the credits allowed by the States under approved experience rating plans.

There is still further proof, if need be, of the deep concern which Congress has manifested in the maintenance and growth of State unemployment compensation funds. Congress has fully recognized that such funds would play a major role during the period of post-war readjustment and would serve as the first line of defense for the millions of workers employed in war industries who would be laid off and unemployed during industry's reconversion and readjustment to peace-time production. The Senate and the House appointed Special Committees on Post-War Economic Policy and Planning, which held extensive hearings on the problem of unemployment compensation in the post-war period.[9] Interviews with representatives of important government and private agencies on post-war problems and plans disclosed that "The fear of unem-

[9] Hearings before the Special Committee on Post-War Economic Policy and Planning, United States Senate, 78th Congress, 2d Session, Pt. 3, Unemployment Compensation; Hearings before the Special Committee on Post-War Economic Policy and Planning, House of Representatives, 78th Congress, 2d Session, Pts. 2 and 3, Economic Problems of the Transition Period.

ployment after the war colors the thinking of all the agencies interviewed. Those concerned with the labor problems give it first rank in their planning."[10] As a result of the recommendations of the said Special Committees on Post-War Economic Policy and Planning,[11] Congress enacted legislation guaranteeing the solvency of State unemployment compensation funds. The War Mobilization and Reconversion Act (Title XII)[12] authorizes loans to the several States for the purpose of bolstering State unemployment funds.

From the foregoing it is evident that Congress never contemplated that the full 3 per cent would be paid to the Federal Government, as the United States will perhaps contend. The primary concern of the Federal legislation was not in revenue to build up the Federal treasury, but, on the contrary, to force the accumulation of State funds for the payment of benefits. It is apparent that Title IX was intended to collect a Federal tax sufficient only to enable the United States, through the Social Security Board, to provide for the administration of State unemployment compensation systems. Any accrual to the general revenue has been incidental and was not contemplated. The tax collected has been more than ample to meet the need.[13]

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[10] Senate Document No. 106, 78th Congress, 1st Session, p. 79.

[11] Senate Report No. 539, Pt. 5, 78th Congress, 2d Session, p. 6; House Report No. 1855, 78th Congress, 2d Session, pp. 27-28.

[12] 50 U.S.C. App. 1667, Senate Report No. 565, 79th Congress, 1st Session, p. 2.

[13] On June 7, 1944, in hearings before the subcommittee of the Committee on Appropriations, United States Senate, 78th Congress, 2d Session, on H.R. 4899, Chairman of the Social Security Board Altmeyer, at page 39 of the hearings report, stated:

"That is another phase, I think that should be borne in mind. The Federal Government gets three-tenths of one per cent of the three per cent unemployment compensation tax which is levied by the Federal Government. That three-tenths of one per cent has

To refuse to recognize that payment to the State would be applicable against the Federal tax under the offset provisions of the Federal legislation would deprive the State of funds needed to pay benefits, thereby defeating the patent intent of Congress. *It must be emphasized that the employees of a delinquent insolvent employer must be paid benefits under Massachusetts law if they are otherwise eligible, regardless of whether or not the State collects the corresponding contributions from the employer.* Congress, by the numerous exceptions and extensions, has evidenced that it considers payment into the State funds as more important to the fundamental purpose of social security than payment into the Federal treasury.

Section 3466 of the Revenue Code does not enter into this consideration; for there is no question of priorities in the State's contention. It is simply a question of the intention of Congress—whether Congress intended that the Federal tax could be satisfied by payment into a State fund. The question must be answered in the affirmative.

The same conclusion was reached by the United States District Court in the case here at bar, where the Court stated (65 F. Supp. 763):

> "The question, nicely analyzed, seemed to me to be one not of priority but of alternative obligation.
>
> "The force of that analysis seemed to me to be more persuasive when the true nature of Title IX of the Social Security Act as portrayed in *Charles C. Steward Machine Co.* v. *Davis*, 301 U. S. 548 was stressed. *As to 90 per cent of the taxes under that Title the objective of Congress was not to collect Federal reve-*

been $450,000,000 in excess of the annual appropriations that Congress has made to the various States for the administration of The Unemployment Compensation Act. So at the present time the Federal Government is $450,000,000 ahead."

nues but to stimulate the creation of and payment to State unemployment compensation funds. It would defeat obvious Congressional intent to lay down a rule which required that this 90 per cent should go to satisfy a Title IX tax claim instead of going to the direct benefit of claimants under State unemployment compensation plans.

"The correctness of the foregoing reasoning seemed to me to be proved by a supposititous case. Suppose A, an insolvent, with $200 in assets, owed $100 to the United States for 1938 Title IX taxes, $90 to Massachusetts for 1938 unemployment compensation contributions and $200 to general creditors. Can it be supposed that a court that was sensitive to the principle of marshalling assets would distribute the assets so that the United States received the first $100, Massachusetts the second $90, and the general creditors $10? To do that would give the two governments more than Congress contemplated and restrict the general creditors to 5 cents on the dollar. Would not a court that was mindful of the strict legal rights of the two governments, of the policies declared in their legislation and of the rights of the general creditors to be subject to no greater priorities than those governmental rights and policies require, distribute $10 to the United States, $90 to Massachusetts, and $100 or 50 cents on the dollar to the general creditors? *This would allow the two governments to receive all that they claimed from the insolvent before his insolvency and would follow the rules of priority established by R.S. § 3466.*" (Emphasis added.)

Even if one does consider Section 3466 in connection with the matter, the State's contention is not inconsistent

with the priorities established by that provision. Section 3466 requires that debts due the United States "be first satisfied." The statute does not say and does not mean that a debt in all cases must be fully paid in cash. For example, the debt may be compromised,[14] and property may be received in payment.[15] The word "satisfied" clearly expresses this thought. An accord and "satisfaction" has long been a recognized means of discharging a debt.

Any construction that the Federal Government must be paid the full 3 per cent in cash first would lead to absurd situations. Assume for the purpose of illustration that the debtor owed the sum of $10,000 to the United States for Federal unemployment tax, and that he owed the State $9000 for unemployment contributions. Assume further that there is available for distribution the amount of $10,500. Yet, if, as may be argued by the Government, the full amount must first be paid to the Federal Government in cash, with no allowance for the offset credit, an absurd situation results. In such case the Federal Government would receive the full $10,000, and $500 would remain for the State. However, the debtor could then obtain a refund from the Federal Government because of the $500 payment to the State on the basis of the offset credit. The $500 refunded by the Federal Government then would be applied to the balance owing to the State and thus in turn qualify the debtor's estate for a refund from the Federal Government for this second $500 paid to the State. This process could be repeated until the State had been paid the full amount of $9000 and the Federal Government retained the amount of $1000, *which was all*

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[14] Revised Statutes, Section 3469, 31 U.S.C. 194; Internal Revenue Code, Section 3761.

[15] Op. Atty. Gen. 298.

that Congress intended the Federal Government should get where a State system had been set up. And certainly Congress never intended that such circuitous process would have to be resorted to in order for the State to obtain the contributions Congress intended it to have.

Thus, in the foregoing case, if the debtor had remained solvent, the State would have received $9000 and the United States $1000. The same result would follow even though the debtor became insolvent but the assets were $10,001 or more. This ultimate result would certainly be in accord with the expressed intention of Congress. But if the assets amounted to $10,000 exactly or less, the interpretation that the Federal Government must be paid its 3 per cent in cash without allowance for the offset credit would give the Federal Government a windfall of $9000, at the expense of the State unemployment compensation funds. Such a result would certainly distort the end sought to be accomplished by this legislation. The additional 90 per cent, never contemplated by Congress as revenue but intended more or less as a penalty to prod the States to create unemployment compensation systems, would be converted into a penalty on the State which had so created a system at the prompting of Congress. For, as pointed out, the State has assumed the obligation of paying benefits to the former employees of the employer regardless of whether or not it has collected the corresponding contributions from the employer.

The United States Government, in support of its contention that it should receive the full 3 per cent Federal unemployment tax, will no doubt rely upon this Court's decisions in *People, ex rel. Gordon,* v. *Campbell,* 329 U.S. 362, and *People, ex rel. Gordon,* v. *United States,* 328 U.S. 8.

Those cases are not controlling on this issue, for, as we have already pointed out, the statements concerning prior-

ities with regard to Title IX taxes are *dicta*. The facts and issues in these two *Gordon* cases were such that it was merely a question as to the relative status of State contributions and taxes under Title VIII.

But it will no doubt be asserted that the legislation under Title VIII and Title IX are so closely related that the reasoning of the Supreme Court is decisive on issues arising under Title IX as well as Title VIII.

It is true that both Titles are designed to promote the economic security of the worker. Title VIII is directed against insecurity caused by loss of income resulting from the incapacities of old age. Loss of income due to the recurrent periods of individual unemployment and to mass cyclical unemployment is sought to be corrected in Title IX.

But, however related the purposes for which Titles VIII and IX were enacted, the means used to achieve that result are different. *Under Title VIII the Federal Government has undertaken the payment of old age benefits. Under Title IX the Federal Government does not pay benefits to unemployed workers; that is undertaken by the States* and the offset credit of 90 per cent of the Federal tax is considered as the means of inducing the establishment of State systems. *There is no offset allowance against taxes for Federal old age and survivors' insurance under Title VIII*, for these funds are needed for the financing of the benefit payments under Title VIII. There is the allowance of the offset credit under Title IX because the Federal Government pays no unemployment benefits and those funds paid into the State systems are accomplishing the Federal purpose. Thus, this Court could say, as it did in *Steward Machine Co.* v. *Davis*, 301 U.S. 548, that the needs of the Federal treasury could be cared for as well by the payment of unemployment compensation contributions to the States as by payment of taxes to the United States.

Thus, although both Title VIII and Title IX have the same end in view, economic security for workers, *the means used to achieve that purpose are divergent.* In the one, the whole tax was intended to be collected as revenue for the financing of benefits to be paid by the Federal Government. In the other, only 10 per cent was intended to come into the Federal treasury, and the rest was to be channelled into State unemployment compensation funds, there to be used in the payment of benefits.

Nor, as has been pointed out, is there a question of priorities. The question is solely whether Congress intended that the Federal claim for unemployment taxes could be "satisfied" by the offset credit for funds paid into State unemployment compensation funds. That such was the Congressional intent has been amply demonstrated.

The *Gordon* cases are not controlling as to the instant case for the further reason that in the *Gordon* cases the State of Illinois sought to enforce the 90 per cent credit allowed to the taxpayer. There is no provision whereby a State may avail itself of this credit. In the instant case the *taxpayer* seeks the 90 per cent credit after having complied, by payment to the State, with the provisions of Section 902.

The United States will probably also contend that *only* the *taxpayer* can pay the State and offset the credit against the Federal tax. That contention ignores the Federal legislation itself, which provides that State contributions may be made and the offset credit allowed when the assets are in the possession of a receiver, trustee or a court of competent jurisdiction.

Section 902(a) of Title IX of the Social Security Amendments of 1939 provided that, in cases where the assets of an employer came into the custody of a receiver any time after August 10, 1939, and until October 9, 1939, the re-

ceiver could obtain the Federal credit for the years 1936, 1937 and 1938 by paying the State.

Section 1601(a)(3) of the Federal Unemployment Tax Act permits the full 90 per cent credit for the preceding year at any time if the assets of the employer come into the possession of a receiver, trustee or a court of competent jurisdiction between the due date and the following June 30, and the State is paid.

Section 701(a) of the Revenue Act of 1940 provided that, if the assets of the employer are in the control of a receiver appointed by or under the control of a court at any time between October 8, 1940, and December 6, 1940, 81 per cent of the credit for 1939 may be obtained by paying the State.

Section 701(b) of the Revenue Act of 1941 permitted a receiver appointed during the extension of time in which a solvent employer could pay the State and thereby obtain the Federal offset to obtain an 81 per cent credit for the year 1940 by paying the State at any time.

A similar provision (Section 602(b), Revenue Code of 1943) permitted such credit for the years 1941 and 1942.

Thus Congress has continuously indicated that it intended that the credit offset could be obtained by payment to the State, *even though insolvency had intervened and the payment is made under a receiver, trustee or court of competent jurisdiction.* This is consistent with the Congressional concern to protect the State funds from which benefits would be paid, even at the expense of the Federal tax.

As for the allowance of the offset frustrating the priority of the Federal Government, it should be noted that Congress has specifically provided that such allowance be permitted in cases of insolvency and further, the Federal priority is *not* denied, for the Federal claim is satisfied to

the same extent by the payment and credit offset as it would be if the payment were made in cash.

In the instant case the funds available for payment of unemployment taxes are insufficient to pay the Federal Government its 10 per cent and the State its full 90 per cent of the Federal claim. *Accordingly, there are three possible methods of handling the offset allowance.*

First Method.

In this method, assume that the full 3 per cent owed to the Federal Government was $10,000, that the amount owed to the State for unemployment contributions was $9000, and that the available funds of the debtor amounted to only $5000. If the entire $5000 is paid to the United States first, its claim will have been satisfied to the extent of $5000 and will remain unsatisfied to the extent of $5000.

If, however, the $5000 is paid to the State, the payment to the State will have the effect of reducing the claim of the United States by the amount of $5000, due to the offset credit, and the unsatisfied part of the claim of the United States remains $5000. Thus the Federal claim is reduced and *satisfied equally* by payment directly to the Federal funds or to the State.

Thus, in the instant case, by this method all funds available for the payment of unemployment taxes would first be applied to the payment of the State's claim for unemployment contributions and the Federal claim correspondingly reduced.

Section 902 as amended gives the *taxpayer or his assignee* the option of doing one of two things: He can pay the United States Government directly, pursuant to the provisions of Section 901, or he may elect to pay the State

Government and thereby receive the credit provided for by Section 902. The exercise of this option to pay the State by *an assignee of the taxpayer* is not in violation of Section 3466 of the United States Revised Statutes, since the payment is made to the State with the consent of the Federal Government and at its express invitation.

The language of Section 902 as amended specifically states that the "*taxpayer* shall be allowed credit for the amount of contributions" paid into an unemployment fund under a State law. There is no reference or language of any kind indicating that this credit can be taken by a State. Recognition of the credit provision on behalf of the taxpayer as against the taxes due the Federal Government is consistent with the indicated purposes of the Social Security Act.

Steward Machine Company v. *Davis*, 301 U.S. 548.

The exercise of this option by the *taxpayer's assignee* in paying the State and receiving therefor a credit from the Federal Government is an action consistent with and not in violation of the provisions of Section 3466.

Second Method.

The second method is the treatment accorded the offset credit by the Federal District Court in the case at bar (65 F. Supp. 763), where the Court discusses and analyzes the decision of the United States Supreme Court in *People, ex rel. Gordon,* v. *United States, supra.* The District Court ordered (after the payment of capital stock taxes and Title VIII taxes) that 10 per cent of the Federal claim

be paid first, and that the balance be paid to the State, with the offset credit resulting therefrom reducing the Federal claim correspondingly. The Court said (referring to *People, ex rel. Gordon, v. United States*):

> "Mr. Justice Black had no occasion to consider the problem whether as to 90 per cent of the amount due for Title IX taxes the United States had not given the taxpayer the option to make payment to Illinois instead of to the United States. That, as I have said, is a problem less of priorities than of the discharge of alternative obligations and of marshalling assets. *In other words, Mr. Justice Black did not specifically consider whether a possible arrangement of claims ought not to be as follows: in a definitely preferred category the claim for capital stock taxes, the claim for Title VIII taxes, and the claim for 10 per cent of Title IX taxes;* and in what I can best describe as a suspended category the claim for 90 per cent of Title IX taxes and the claim for State unemployment compensation contributions,—the taxpayer *or his assignee or a court charged with administration of insolvent estates having the right to elect to pay the State and defeat 90 per cent of the United States Title IX claim;* . . ." (Emphasis ours.)

Using the same illustration as in the first method, where the Federal claim was $10,000, the State claim for contributions was $9000, and the funds available for distribution amounted to $5000—under the treatment of the Massachusetts Court the Federal Government would receive 10 per cent of its claim or $1000 and the balance of available funds would be applied to the State claim, giving the State $4000, or 45 per cent of its claim.

The inequities of this method are apparent in that it allocates a disproportionately large share of available funds for the costs of administration at the expense of the State funds which are devoted to the payment of benefits, the actual purpose of the legislative program. This is contrary to the intention of Congress, which regarded 90 per cent as the proper share to safeguard the funds for the payment of benefits.

Third Method.

The third method is one in which the available funds would be allocated as follows: 10 per cent of the available funds to the Federal Government and 90 per cent to the State Government, the latter amount being offset against the Federal claim. This procedure is in keeping with the underlying purposes of the legislation. It gives consideration to the Federal Government for the amount which is to be used for the administrative purposes, and to the State Government in the maintenance of funds for the payment of unemployment benefits, and *the allocation is made in the proportion which Congress considered would give protection to both the costs of administration and the State funds from which benefits are to be paid.*

Using the same illustration with the Government claim for $10,000, the State claim for $9000, and the available funds of $5000, the allocation of available funds would be as follows: 10 per cent of the available funds or $500 to the Federal Government and 90 per cent of the available funds or $4500 to the State Government.

Thus, in the above example, by means of the offset credit the Federal claim is reduced and satisfied to the extent of $5000, which is exactly the same amount that it would be reduced and satisfied if the full amount of cash were paid directly to the Federal Government.

Proper Method: First Method.

It is respectfully submitted that the proper method of handling the 90 per cent offset allowance is that indicated in the first method discussed. A taxpayer's liability to pay the many types of taxes imposed by the Federal Government is a single liability. There is no provision of law whereby a priority is created in favor of one type of Federal tax over another. The credit provision of Section 902 of the Social Security Act as amended, therefore, is one which can be availed of by the taxpayer or his assignee as against his liability for the payment of any Federal tax. A tax is a debt and the principle that a debtor making a payment to a creditor can direct how the payment shall be applied in the event there is more than one debt has been held applicable to the payment of taxes.

> "Ordinarily when a debtor makes a payment to a creditor, he can direct how the payment shall be applied if there is more than one debt, and this rule has been applied to payment of taxes."
>
> *Standard Oil Co.* v. *United States Court of Claims*, 5 F. Supp. 976, 986.
>
> *National Bank of the Commonwealth* v. *Mechanics' National Bank*, 94 U.S. 437.
>
> *Korbly* v. *Springfield Institution for Savings*, 245 U.S. 330.

> "Government cannot bind them [taxpayers] by the exercise of any supposed power to make application of the payments made.
>
> "The general doctrine as to the application of payments is, that if the debtors fail to apply them, the government may do so. If both fail, the law will make

the application, as the principles of justice shall require."

United States v. *Linn*, 2 McLean, 501.

The assignee, in making payment to the Commonwealth of Massachusetts, clearly indicated the particular Federal tax to which said payment was to apply, namely, Title IX tax. He, on behalf of the taxpayer, was actually paying *one of the several Federal taxes owed by the taxpayer.* To hold, as did the District Court and the Circuit Court of Appeals, that the capital stock tax and Title VIII taxes had preference over the full payment of the Title IX tax was to create a preference of one Federal tax over another. Such a conclusion would be directly contrary to the application clearly indicated by the taxpayer as to which tax said payment should apply.

The payment made by the assignee of the taxpayer to the Commonwealth of Massachusetts in the case at bar, therefore, is one with reference to which he should receive full credit against the taxpayer's liability to pay the taxes imposed by Section 901 of Title IX of the Social Security Act, Title VIII taxes, capital stock tax, or any other Federal tax of his assignor since the payment was made with the permission of the Federal Government pursuant to the provisions of Section 902.

VII. Conclusion.

In conclusion, the petitioners most respectfully submit that the assignee of the taxpayer, Carlton W. Spencer, had a right to pay in full the unemployment tax owed by the taxpayer to the Commonwealth of Massachusetts, by virtue of Section 902 of the Federal Social Security Act, be-

fore paying *any of the various Federal taxes* owed by the taxpayer.

The petitioners therefore pray that the judgment of the Circuit Court of Appeals for the First Circuit, entered on April 2, 1947, be reversed, and that this Honorable Court order that a judgment be entered for Carlton W. Spencer.

Respectfully submitted,

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